

How to calculate the break-even sales for your business

In my last article I outlined the need to know and measure the key numbers which drive the profitability of your business. It's also essential to know the level of sales needed to break even. Normally this is calculated on an annual basis but it also helps to know the break even sales for **each month** as some months have higher expenses than others.

Break even analysis is especially important for new businesses and ideally this calculation should be made before entering into any new business. While the benefits of calculating the break even sales for a new business are obvious it's a calculation that should be made at least once a year for all businesses.

Why? Because things change, costs can increase and profit margins may decline, both of which can have a profound impact on the level of sales required to break even.

Break even sales is the level of sales necessary to cover all expenses of the business i.e. the point of no profit or loss.

Calculating the break even sales for a business is a three step process:

1. The first step is to determine your total Fixed Expenses. A fixed expense is an expense which is unlikely to vary relative to your current level of production or turnover. You will normally find these in your profit & loss statement or budget/forecast if you are looking forward. Examples of fixed expenses include rent and wages.
2. The next step is to determine your Gross Profit margin percentage (GP%). GP% is calculated by dividing your gross profit by your sales, as with fixed expenses these numbers can be found on your profit & loss or budget/forecast.
3. When you have these numbers the Break Even Sales is simply calculated by dividing the fixed expenses by the GP %.

Set out below is an example;

1. Fixed Expenses	\$250,000
2. GP Margin	35%
3. Break Even Sales ($\$250,000 \div 0.35$)	\$714,286

The proof of this calculation is set out below:

Sales	\$714,286
Less Cost of Goods Sold (65%)	464,286
Gross Profit (35%)	250,000
Less Fixed Expenses	250,000
Net Profit	Nil

Calculating your break even sales helps you understand the financial dynamics of your business. Once you have made the calculations they can be used to show the impact of a change in costs or GP Margins. They will also help you calculate the level of sales required to generate your desired profit.

If you need help in working out your **business break even** please give me a call at GTC.

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